

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROBERT TRUSNOVEC	:	DETERMINATION
D/B/A YAPHANK COMMUNITY SHOP	:	DTA NO. 811135
	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1987	:	
through February 28, 1990.	:	

Petitioner, Robert Trusnovac d/b/a Yaphank Community Shop, P.O. Box 674, Wading River, New York 11792, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1987 through February 28, 1990.

A hearing was commenced before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on July 22, 1993 at 1:15 P.M. and continued to conclusion at the same location on November 3, 1994¹ at 1:15 P.M. Petitioner obtained permission to submit a better copy of his Exhibit "16", which was received on December 5, 1994. No briefs were submitted by the parties. Petitioner appeared pro se. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

¹This 16-month delay until November 3, 1994 to complete the hearing resulted from the accommodation of petitioner, who suffered various ailments from a car accident, which caused the postponement of the hearing, at petitioner's request, on four occasions.

ISSUES

I. Whether the Division of Taxation made an adequate request to examine petitioner's books and records so that petitioner's lack of response to such request justified the Division of Taxation's use of audit results from a prior sales tax audit of an earlier period as a basis for estimating additional sales tax for the three-year period at issue here, in lieu of an audit of petitioner's books and records.

II. Whether petitioner's books and records were insufficient to verify taxable sales receipts and to permit the Division of Taxation to conduct a complete audit so that the observation test, which the Division of Taxation performed at the direction of a conferee of the Bureau of Conciliation and Mediation Services, was properly performed.

III. Whether, if the observation test was properly performed, such test was an audit method reasonably calculated to reflect sales and use taxes due.

IV. Whether, if the observation test was properly performed and was an audit method reasonably calculated to reflect sales and use taxes due, petitioner by the introduction of clear and convincing evidence established that there were errors in the observation test.

V. Whether petitioner has established reasonable cause and the absence of willful neglect to justify the abatement of penalties.

FINDINGS OF FACT

Petitioner, Robert Trusnovec, owns and operates a delicatessen located on Main Street in Yaphank, New York (which is on Long Island) as a sole proprietorship. Mr. Trusnovec, who noted that he started working for his father in the business when he was 13 years old, testified that he has owned the delicatessen since January 12, 1970 (tr., p. 77). The delicatessen is a labor-intensive family business, which was closed for only two days each year, Christmas and New Year's.

Mr. Trusnovec has had a long and troubled relationship with State sales tax auditors in the course of three audits, including the audit at issue, which is the third audit conducted by the Division of Taxation ("Division") of his delicatessen's taxable sales. It is observed that a fourth

audit, for the period June 1, 1990 through May 31, 1993, was commenced during the summer of 1993 and apparently is still underway. (Petitioner's Exhibit "15" includes a letter dated June 18, 1993 of the State's auditor conducting this fourth audit.)

The Previous Audit (Audit #2)²

The Tax Appeals Tribunal, in its decision dated March 6, 1993 in the Matter of Trusnovec (DTA #805982) concerning the imposition of additional sales and use taxes on petitioner for the period June 1, 1981 through November 30, 1986, "affirm[ed] the determination of the Administrative Law Judge for the reasons stated in said determination." The Administrative Law Judge, in his determination dated July 19, 1990, upheld the Division's use of an observation test to estimate the taxable sales of petitioner's delicatessen. The auditor, with one assistant, had conducted an observation of petitioner's sales of prepared foods on Thursday, September 25, 1986. Finding of Fact "6" of the determination described the auditor's calculation that additional sales tax of \$103,523.40 was due from petitioner for this earlier period, which consisted of 5½ years (June 1, 1981 through November 30, 1986), as follows:

"[O]n September 26, 1986, [footnote omitted] the auditor (and one assistant) conducted an observation of petitioner's sales of prepared foods between the hours of 6:00 A.M. and 2:00 P.M. The results of this observation test included the following:

"(a) Gross sales for the observation, per cash register summary, totalled \$2,137.54. Taxable prepared food sales, as observed, totalled \$718.81. The difference between these two amounts (\$1,418.73) represented 'other sales' (taxable and nontaxable).

"(b) The auditor calculated weekly gross sales of \$13,884.00 as follows:

²Petitioner noted that during the first sales tax audit of the delicatessen, his father, who apparently was still involved in the business, was dying and petitioner was in the hospital recovering from injuries suffered after being struck by a car in a hit-and-run accident. According to petitioner, the business was shut down by the Division for an unspecified period of time as a result of the first audit and that he was unable to challenge the findings of the first audit (tr., p. 257).

observed taxable prepared food sales
of \$718.81 x 5.5 days per week.....\$ 3,953.00
plus
other sales of \$1,418.73 x 7.0 days per week.. 9,931.00
= Gross Sales.....~~\$13,884.00~~

"(c) The auditor calculated weekly and quarterly taxable sales as follows:

weekly taxable prepared food sales.....\$ 3,953.00
plus
other sales of \$1,418.73 per day x
31.18%³ taxable x 7 days per week..... 3,097.00
= weekly taxable sales.....\$ 7,050.00
number of weeks per quarter.....x 13
= quarterly taxable sales.....~~\$91,650.00~~

"(d) The auditor compared weekly taxable sales (\$7,050.00) to weekly gross sales (\$13,884.00), determining a taxable ratio of 51%. In turn, by extension, the auditor computed gross sales of \$4,021,003.00 and taxable sales of \$2,057,387.00 for the audit period. This latter figure resulted in sales tax liability of \$150,823.35 which, after credit for tax paid (\$47,299.95) leaves additional tax due of \$103,523.40.

"Among other additional steps, the auditor divided petitioner's reported gross sales per returns for the quarterly period ended November 30, 1986, (\$71,855.00), by the 91 days in such three-month quarterly period, yielding an average daily gross sale amount of \$790.00. The auditor compared such resulting daily gross sale amount to the \$718.81 in taxable sales of prepared foods as determined during the 8-hour observation test, concluding that petitioner's returns were inaccurate and incorrect as filed. Accordingly, the auditor recommended assessment of the \$103,523.40 of tax found due on audit, plus penalty and interest."

Request for Records for a Third Audit

The Division presented its evidence in a clear manner, offering the candid testimony of Robert DeFilippis, a sales tax auditor employed in the Division's Suffolk District Office, who was responsible for the third sales tax audit of petitioner's delicatessen. Mr. DeFilippis detailed his attempt to obtain the books and records of petitioner's business in order to conduct his audit. On March 22, 1990 (which it is observed is a date prior to the issuance of the Administrative Law Judge determination dated July 19, 1990 concerning the second sales tax audit), the auditor mailed to petitioner a letter dated March 21, 1990 requesting that petitioner telephone him "in

A footnote in the determination noted that "[t]he estimate that 31.18% of other sales represent taxable grocery sales is based on Division of Taxation experience. There is no evidence that petitioner challenges such estimate."

order to arrange a mutually agreeable time" for a field examination of petitioner's sales tax returns for the period March 1, 1987 to the date of the letter. The auditor requested that the following records be made available:

"All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include Income Tax returns, journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records. Additional information may be required during the course of the audit."

The address on this letter dated March 21, 1990 requesting books and records, which appears to have been a mailing label generated by the Division's computer system, was as follows:

"Robert Trusnovec/Yaphank
Communit [sic]
-- Main St
Yaph?nk⁴ [sic] NY 11980"

The auditor received no response from petitioner to his letter dated March 21, 1990, and a couple of weeks later, on April 5, 1990, he mailed another copy of this letter to petitioner. With no response from petitioner to this second mailing of the letter dated March 21, 1990, on April 24, 1990, the auditor sent by certified mail another copy of the March 21, 1990 letter, along with a waiver and extension of the period of limitation to assess sales tax for petitioner's review and signature. The auditor's certified mailing of April 24, 1990 was "returned to sender" by the post office with the reason "unclaimed" checked on the post office rubber stamp which lists seven potential reasons for returning certified mail to the sender.⁵

⁴The letter designated by a "?" was unreadable.

⁵The other reasons listed were: refused; addressee unknown; insufficient address; no such street; no such number; no such office in state. It is observed that included in the Division's Exhibit "F" is a photocopy of "Certified Mail No. 559765" with an office meter stamp showing the date of April 25, 1990 at Hauppauge, New York (which is the location of the Division's Suffolk District Office). A rubber stamp indicates that the certified mailing was received back by the "Suffolk Office Sales Tax" on May 14, 1990. This photocopy also shows the following address for petitioner:

"Robert Trusnovec d/b/a Yaphank Community Shop
-- Main Street
Yaphank, NY 11980"

On May 16, 1990, two days after he received his certified letter back, the auditor "made copies of everything I sent on April 24th.⁶ And I sent it to the vendor via first-class mail" (tr., p. 36). The auditor still did not get a response from petitioner. In sum, the auditor mailed his letter requesting records to petitioner three times by first-class mail and once by certified mail. It is observed that the letters sent by first-class mail never came back to the auditor, only the letter sent by certified mail was returned by the post office to the auditor.

Petitioner Denies Receipt of Appointment Letter

Petitioner denied receiving any of the auditor's mailings of the letter requesting the scheduling of an appointment for an examination of his books and records for the period at issue. He suggested that the address used by the auditor "just plain Main Street, Yaphank, New York" might explain why he did not receive any of the mailings (tr., p. 234). According to petitioner, the post office decided, despite the fact that Yaphank was a small town where "everybody knows everybody", if a letter "didn't have a post office box on it", it would not be delivered (tr., p. 216). Petitioner introduced into evidence a letter dated July 21, 1993 from Theresa A. Hansen, Financial Services Officer of the Yaphank, New York office of Key Bank of New York on the bank's letterhead to the Division's representative explaining that the bank had problems sending mail to petitioner during 1990:

"As of 1990, our customer began experiencing problems with mail delivery to his P.O. box . . .

We have since had to hand deliver bank statements to this customer."

On cross-examination, the auditor testified as follows concerning why he did not phone petitioner at his delicatessen or visit the store to deliver the appointment letter:

Robert Trusnovec: "The reason that you wouldn't go any further as far as notifying me for books and records further than you did, because of other tax agents or auditors saying I was a real bad person, did I have a bad reputation being nasty

⁶As noted in footnote "5", it would appear that the letter sent by certified mail was actually sent on April 25, 1990.

and something like that with the people in New York State Taxation and Finance? What I am getting: Is that the reason? The people say I was a bad person?"

Auditor: "I think I said in my testimony last time is that there is a couple instances where you and your representative had sales tax personnel removed either from your property or from a courtroom. And the previous audit, you or your representative requested a second observation. When an auditor and his team leader went to make the observation, you asked the Suffolk County police to have them removed from your property."

Robert Trusnovec: "So, basically that's your reason for not going any further, just to go and make your assessment? If I didn't have that type of a reputation, if people had not said that about me, you would have called me or done something like that to find out why I had not responded to you?"

Auditor: "Most likely would have been the case. It just seemed to me that if you were not responding to my first class mail, that you just did not want to cooperate with this audit."

Robert Trusnovec: "Would that make much sense, though, the situation I was sitting in?"

Auditor: "Well, the prior audit, what had happened with the prior audit when you prevented the auditors from doing what you, in fact, and, in fact, requested them to do, seemed to me that you were not cooperating with them and you were not responding to my letters. I felt you were not cooperating with the follow up audit."

Robert Trusnovec: "But yet you still came in the store and didn't say anything to anyone, correct?"

Auditor: "I came into the store to observe."

Robert Trusnovec: "Which you could have done something then and handed somebody a piece of paper and envelope, correct? And another time you stood outside the window with Mr. Hoffman, I believe it was?"

Auditor: "We were in the store" (tr., pp. 237-239).

A review of the Administrative Law Judge determination dated July 19, 1990 concerning the prior audit discloses that State auditors arrived, with no advance notice, at the store to conduct a second observation test. Petitioner testified that on that day, he and his then representative were attending a meeting concerning a personal income tax audit with State personnel. Petitioner would not consent to the observation test being conducted when he was away from his store, and it appears that the police were phoned in order to ask the sales tax auditors to leave the delicatessen's parking area. As noted in Finding of Fact "7" of the determination, "In turn, the auditors relocated across the street and counted the number of

persons entering petitioner's premises."

The auditor's reference to the removal of sales tax personnel from a courtroom at the request of petitioner and/or his then representative is not explained. Although somewhat speculative, a request to segregate witnesses at the prior formal hearing might explain such "removal" of sales tax personnel.

Finally, it is noted that the auditor testified that "normally" he gets a response to appointment letters and that the matter at hand is the only one he can recall where he did not get a response (tr., p. 60). In short, this was a unique situation.

Taxable Sales as Reported by Petitioner

Included in the Division's Exhibit "F" is a "Schedule of Returns Filed". This schedule shows that, since 1980, petitioner has reported and paid sales tax on taxable sales of his delicatessen which he was estimating as 40% of his reported gross sales. For the period at issue, petitioner reported gross sales, taxable sales and tax due (which was paid) as follows:

Period <u>Ended</u>	Gross <u>Sales</u>	Taxable <u>Sales</u> ⁷	Tax <u>Due</u>
5/31/87	\$ 74,572.00	\$ 29,828.00	\$ 2,237.00
8/31/87	90,955.00	36,382.00	2,729.00
11/30/87	85,604.00	34,241.00	2,568.00
2/29/88	75,429.00	30,171.00	2,262.00
5/31/88	70,594.00	28,237.00	2,117.00
8/31/88	69,547.00	27,819.00	2,086.00
11/30/88	60,717.00	24,287.00	1,821.00
2/28/89	54,506.00	21,802.00	1,635.00
5/31/89	61,521.00	24,608.00	1,845.00
8/31/89	67,118.00	26,847.00	2,013.00
11/30/89	52,523.00	21,009.00	1,575.00
2/28/90	<u>42,203.00</u>	<u>16,881.00</u>	<u>1,266.00</u>
Totals	\$805,289.00	\$322,112.00	\$24,154.00

Auditor Estimates
Additional Sales Tax Due
Based Upon Prior Audit Results

The auditor testified that on Tuesday, June 12, 1990 (which it is

⁷Each of the amounts listed under the column heading "taxable sales" equals 40% of the respective amounts under the "gross sales" column heading.

observed is a date prior to the issuance of the determination dated July 19, 1990 concerning the second sales tax audit), he went to petitioner's delicatessen and "from the outside, I counted the number of persons entering the deli during the hours of eleven a.m. to one p.m." (tr., p. 38).

The auditor compared his count made on June 12, 1990 to "a similar count that was made in the prior audit in 1987 [on Friday, November 6, 1987], and I found that there was -- I counted 31 more people entering the deli the day that I did the count" (tr., p. 38). The auditor determined that he could utilize the audit results from the second audit because, from his count in 1990, he concluded that "the business had not declined in this three-year period."

The auditor testified that audited taxable sales for the prior audit period of June 1, 1981 through November 30, 1986 was determined to be \$1,455,080.00.⁸ He divided this amount by 22, which represented the number of sales tax quarters in the prior audit period, to determine average taxable sales per quarter of \$66,140.00. He then added an inflation factor of 5% per year to determine taxable sales for each of the 12 quarters at issue herein as follows:

Average taxable sales per period prior to 1987	\$66,140.00
	x <u>1.05</u>
Average taxable sales per period during 1987	\$69,447.00
	x <u>1.05</u>
Average taxable sales per period during 1988	\$72,919.00
	x <u>1.05</u>
Average taxable sales per period during 1989	\$76,565.00
	x <u>1.05</u>
Average taxable sales per period during 1990	\$80,393.00

Using these amounts as adjusted by an inflation factor, the auditor estimated petitioner's taxable sales for the three-year period at issue as \$886,670.00 computed as follows:

Quarter <u>Ended</u>	Audited Taxable <u>Sales</u>	Audited Sales Tax Due	Sales Tax Paid	Additional Sales Tax <u>Due</u>
May 31, 1987	\$ 69,447.00	\$ 5,208.53	\$ 2,237.00	\$ 2,971.53

⁸As noted in Finding of Fact "3", the auditor of this earlier period initially determined taxable sales of \$2,057,387.00. This larger amount was reduced pursuant to a conference in the former Tax Appeals Bureau.

August 31, 1987	69,447.00	5,208.52	2,729.00	2,479.52
November 30, 1987	69,447.00	5,208.53	2,568.00	2,640.53
February 29, 1988	72,919.00	5,468.93	2,262.00	3,206.93
May 31, 1988	72,919.00	5,468.92	2,117.00	3,351.92
August 31, 1988	72,919.00	5,468.93	2,086.00	3,382.93
November 30, 1988	72,919.00	5,468.92	1,821.00	3,647.92
February 28, 1989	76,565.00	5,742.38	1,635.00	4,107.38
May 31, 1989	76,565.00	5,742.37	1,845.00	3,897.37
August 31, 1989	76,565.00	5,742.38	2,013.00	3,729.38

November 30, 1989	76,565.00	5,742.37	1,575.00	4,167.37
February 28, 1990	<u>80,393.00</u>	<u>6,029.47</u>	<u>1,266.00</u>	<u>4,763.47</u>
Total	\$886,670.00	\$66,500.25	\$24,154.00	\$42,346.25

The auditor summarized the results of his analysis on the cover sheet of his field audit report as follows:

	<u>Reported</u>	<u>After Audit</u>
Gross Sales	\$805,289.00	\$1,369,847.00
Taxable Sales	322,112.00	886,670.00

In other words, the auditor determined that petitioner underreported his taxable sales by \$564,558.00 ($\$886,670.00 - \$322,112.00 = \$564,558.00$, which is also the difference between gross sales after audit of \$1,369,847.00 and reported gross sales of \$805,289.00).

Based upon the auditor's analysis detailed in Finding of Fact "8", a Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated June 18, 1990 (a date still prior to the first determination dated July 19, 1990) was issued against petitioner asserting tax due of \$42,346.25, plus penalty and interest. The auditor testified that penalty was imposed due to the substantial underreporting of taxable sales despite two prior audits. The total amount asserted due was broken down by quarters in a fashion that corresponds to the quarterly breakdown of "additional sales tax due" shown in the column with such heading in Finding of Fact "8". In addition, omnibus penalty totalling \$4,234.62 was asserted due against petitioner by a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due also dated June 18, 1990 because, in the auditor's words, more than 25% "of the tax that was originally reported" was "found to be due" (tr., p. 44).

Conciliation Conferee Reduces Assessment

A conciliation conference was conducted on May 23, 1991 at which time the conferee directed the auditor to examine petitioner's records and to perform an observation test of the delicatessen's sales.

The auditor testified that the following records were made available for his review:

- (a) A day book for the period March 1987 through December 1989;
- (b) Federal income tax returns for the years 1987, 1988 and 1989;

(c) Summaries of cash register tapes for 1989; and

(d) Purchase invoices for cash purchases for 1989.

Business checks and bank statements were not presented to the auditor.

According to the auditor, "by mutual agreement between petitioner's [then] representative Vito LaMonica, an enrolled agent working for a certified public accounting firm and [the auditor's] team leader Gary Glubiak" (tr., p. 50), Wednesday, July 10, 1991 was selected as the day to perform an observation test. The auditor and three colleagues observed the taxable sales of petitioner's delicatessen on this chosen date which amounted to \$869.93. The business has two cash registers, one in the front of the store and one at the rear, and the auditors observed purchases by 285 customers as follows:

	Number of <u>Customers</u>
Front register	
6:00 A.M. to 1:30 P.M.	93
Rear register	
6:00 A.M. to 1:30 P.M.	50
Front register	
1:30 P.M. to closing	128
Rear register	
1:30 P.M. to closing	<u>14</u>
Total	285

The Division's Exhibit "G" includes 16 pages of detailed listings of the delicatessen's taxable sales. Two summary pages show the following taxable sales:

<u>Item</u>	<u>Item Price</u>	Front Register 6:00 A.M.- 1:30 P.M.	Rear Register 6:00 A.M.- 1:30 P.M.	Front Register 1:30 P.M.- Closing	Rear Register 1:30 P.M.- Closing	Total of Particular Item Sold	<u>Totals</u>
Coffee	\$.60	101	6	21	--	128	\$ 76.80
	.95	26	--	5	--	31	29.45
Hot chocolate	.60	--	--	1	--	1	.60
Buttered rolls/bagels	.60	41	3	3	--	47	28.20
with cream cheese	.95	13	--	--	--	13	12.35
Iced tea	.95	2	1	5	2	10	9.50
	1.75	7	1	12	--	20	35.00
Very Fine drinks	.90	2	--	--	--	2	1.80
Gatorade	1.00	6	3	8	--	17	17.00
<u>Soda</u>							
12 oz.	.90	1	20	22	1	44	39.60
16 oz.	1.00	19	1	21	6	47	47.00
1 ltr.	1.40	3	1	7	--	11	15.40
2 ltr.	1.45	--	--	1	2	3	4.35

Wine coolers	1.00	2	--	--	--	2	2.00
Evian water	2.00	2	--	--	1	3	6.00
<u>Beer</u>							
12 oz.	1.10	3	--	11	--	14	15.40
16 oz.	1.40	--	--	14	2	16	22.40
6 pack	3.95	--	--	1	--	1	3.95
6 pack	5.50	--	--	8	1	9	49.50
Cigarettes	2.40	36	--	23	--	59	141.60
Cigars	1.89	1	--	--	--	1	1.89
	1.94	--	--	--	1	1	1.94
Toilet paper	1.00	--	--	1	--	1	1.00
Ice	1.50	--	--	4	--	4	6.00
Candy/gum	.60	18	--	3	--	21	12.60
Buttered muffin	1.25	1	--	--	--	1	1.25
Pops	.15	1	--	--	--	1	.15
Cups	.89	1	--	--	--	1	.89
Sun glasses	5.99	1	--	--	--	1	5.99
<u>Prepared Foods:</u>							
<u>Breakfast</u>							
Egg on Roll w/coffee or juice	.99	--	8	--	--	8	7.92
2 eggs on roll w/coffee or juice	1.29	--	24	--	--	24	30.96
Above w/peppers or mushrooms	1.79	--	6	--	--	6	10.74
<u>Extras</u>							
Home fries	.30	--	2	--	--	2	.60

Meats	.50	--	29	--	--	29	14.50
Cheese	.30	--	3	--	--	3	.90
Home fries special	2.89	--	3	--	--	3	8.67
<u>Sandwiches</u>							
Other	?	--	30.95	--	3.00	?	33.95
Cold	2.00	--	3	--	--	3	6.00
Cold	2.25	--	3	--	2	5	11.25
Cold	2.75	--	4	--	3	7	19.25
Cold	3.25	--	5	1	5	11	35.75
<u>Extras</u>							
Dressing/tomatoes/rolls	.30	--	5	--	--	5	1.50
Hot sandwiches	--	--	28.90	7.00	--	--	35.90
Chili							
small	1.50	--	1	--	--	1	1.50
large	2.25	--	--	1	3	4	9.00
largest	2.95	1	2	--	--	3	8.85
Soups							
small	.75	--	1	--	--	1	.75
large	1.50	--	2	--	--	2	3.00
Macaroni & cheese	2.25	--	--	1	--	1	2.25
<u>Specials</u>							
Italian special	3.49	--	1	--	--	1	3.49
Salad bar		14.65	18.94	--	--	--	<u>33.59</u>
						Total	\$869.93

The conferee reviewed the observation test performed by the auditors and directed that the taxable sales observed on Wednesday, July 10, 1994 of \$869.93 should be reduced: (1) by \$33.59 for salad bar sales because, according to auditor DeFilippis, "Mr. Trusnovec told the conferee that he did not have a salad bar during the audit period" (tr., p. 52); and (2) by 10% to account for two years of inflation at 5% per year so that the number would equate to sales on Wednesdays in July 1989, which the auditors compared to the sales observed on July 10, 1991. Consequently, at the direction of the conferee, taxable sales for the observation test were reduced from \$869.93 to \$752.71.

Auditor DeFilippis reviewed petitioner's records (in particular, cash register tape summaries) to calculate an average for taxable sales reported by petitioner for Wednesdays in July 1989 as follows:

<u>Wednesdays in July 1989</u>	<u>Gross Sales</u>
July 5	\$ 718.33
July 12	809.62
July 19	830.05
July 26	<u>902.23</u>
	\$3,260.23

divided by 4 =
\$815.06 Average gross sales
x .40 Reported taxable sales⁹
\$326.02 Reported taxable sales

The auditor then determined a margin of error of 230.88% by comparing taxable sales per observation of \$752.71 to this average of taxable sales reported of \$326.02 (\$752.71 divided by \$326.02 equals 2.30878, which expressed as a percentage is 230.88%). Applying this margin of error of 230.88% to taxable sales reported for the period at issue (March 1, 1987 through February 28, 1990) of \$322,112.00 resulted in audited taxable sales of \$734,692.00, with additional taxable sales of \$421,580.00 (\$734,692.00 - \$322,112.00 = \$421,580.00).

A schedule included in Exhibit "G" shows the recalculation of additional sales tax due for the audit period of \$31,618.50 as follows:

Period <u>Ended</u>	Taxable Sales Reported	Additional Taxable Sales @ 1.3088 ¹⁰	Additional Sales Tax <u>Due</u>
5/31/87	\$ 29,828.00	\$ 39,039.00	\$ 2,927.93
8/31/87	36,382.00	47,617.00	3,571.28
11/30/87	34,241.00	44,815.00	3,361.13

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Petitioner estimated his taxable sales as 40% of the sales shown on his cash register tape summaries as noted in Footnote "7" (which apparently did not include his Lotto sales).

¹⁰The auditor explained that he utilized "an accounting shortcut just to determine additional taxable sales in lieu of total audited taxable sales" (tr., p. 54). A multiplier of 2.3088 would have been used to determine total audited taxable sales.

2/29/88	30,171.00	39,488.00	2,961.60
5/31/88	28,237.00	36,957.00	2,771.78
8/31/88	27,819.00	36,410.00	2,730.75
11/30/88	24,287.00	31,787.00	2,384.03
2/28/89	21,802.00	28,534.00	2,140.05
5/31/89	24,608.00	32,207.00	2,415.53
8/31/89	26,847.00	35,137.00	2,635.28
11/30/89	21,009.00	27,497.00	2,062.28
2/28/90	<u>16,881.00</u>	<u>22,092.00</u>	<u>1,656.86</u>
Total	\$322,112.00	\$421,580.00	\$31,618.50

As a result of the observation test as adjusted, a Conciliation Order dated January 24, 1992 was issued which recomputed the notices of determination described in Finding of Fact "9" by reducing (i) tax asserted as due of \$42,346.25 to \$31,618.50 and (ii) omnibus penalty asserted as due of \$4,234.62 to \$3,161.85.

Petitioner Contests the Observation Test

Petitioner persists in arguing that his books and records were complete and that the Division improperly utilized an observation test to estimate his sales, even in the face of the fact that petitioner himself estimated his taxable sales as 40% of the sales shown on his cash register tape summaries. Consequently, it is necessary to closely review the books and records maintained by petitioner for his delicatessen.

Most important, it is observed that petitioner does not have any records that document the delicatessen's individual sales that were subject to sales tax. The cash register tape summaries produced by the delicatessen's registers show only total sales for a (usually) 24-hour period, which, according to Mr. Trusnovec's testimony, ran from approximately 2:00 P.M. to 2:00 P.M. of the following day (so that, for example, the register tape for November 3rd would actually cover the period from 2:00 P.M., November 2nd to 2:00 P.M. on November 3rd (tr., p. 210).

At the hearing, a close examination was made of petitioner's records as they pertain to one randomly selected day, November 1, 1989. The so-called daily envelope¹¹ for November 1,

¹¹The daily envelopes constituted the bulk of the documents introduced into the record by petitioner.

1989 (petitioner's Exhibit "9-1") contained the following invoices for purchases made by petitioner in cash for his delicatessen:

<u>Vendor</u>	<u>Items Purchased</u>	<u>Amount of Purchase Invoice</u>
Tuscan	Milk and Dairy Products	\$170.69
Conservative Gas	Propane gas	91.92
Frito-Lay	Snack foods	<u>137.40</u>
	Total	\$400.01

Mr. Trusnovec testified that he paid in cash, not by check, because these vendors "came right to the door" (tr., p. 119). Attached to the outside of this representative daily envelope were the following: (1) a "New York's Lottery" slip summarizing petitioner's Lotto sales in the amount of \$585.50 for November 1, 1989; (2) a slip which summarized by category the delicatessen's cash purchases for the day as well as total sales for the day of \$489.88 and sales tax of \$14.70; and (3) a cash register tape which was unreadable so that another envelope was randomly selected by the Administrative Law Judge (for Saturday, April 1, 1989) to permit petitioner to describe the nature of the cash register tapes included with his daily envelopes. The cash register tape attached to the daily envelope for Saturday, April 1, 1989 (petitioner's Exhibit "9-2"), according to Mr. Trusnovec, shows "the cash that was taken into the register" of \$573.10 and "the amount of the tax that the register computed" was \$16.11 (tr., p. 126-127). This tape also shows according to petitioner a "gross total", from the very first day that the register went into use until April 1, 1989,

of \$797,551.78. Mr. Trusnovec testified that he has used the same two registers in his delicatessen since 1977. The registers each have a separate key for taxable sales and nontaxable sales. They do not produce a register tape that identifies the item being purchased.

Petitioner testified that about one month after the preparation of a daily envelope, he would transfer the daily envelope amounts to his so-called yearly "journal". For the representative example detailed in Finding of Fact "17", it was observed that the journal for 1989 (petitioner's Exhibit "2") had corresponding entries.

At the hearing on July 22, 1993, petitioner explained that he estimated that 40% of his sales were subject to sales tax during the period at issue by an analysis of his purchases. At the continuation of the hearing on November 3, 1994, petitioner testified that he performed his own "observation tests" with his wife for Wednesday, July 24, 1991 and for Saturday, July 28, 1991 with results significantly different from the Division's observation test. However, this testimony was not persuasive. It is observed that at the earlier hearing petitioner made no mention that he had performed his own observation tests two years earlier, and moreover, he failed to document his "observation tests" with the type of detailed schedules developed by the Division for its observation test, as noted in Finding of Fact "12".

Petitioner sought to undercut the results of the Division's "observation test" by the following additional evidence:

- (1) photographs of a farmstand near his delicatessen which was in operation on the day of the observation test, but not during the period at issue which, according to petitioner, meant an increase to his delicatessen's sales of \$150.00 to \$200.00 per day because the farmstand apparently brought more customers to his business;
- (2) testimony that he ran a promotion related to Lotto during the period when the observation test was conducted but not during the sales quarters at issue;
- (3) photographs of competitors' stores¹² and of petitioner's personal automobiles to show he did not make "these kinds of money" (tr., p. 201) claimed by the Division; and
- (4) sworn statements by his prior representative, Vito W. LaMonica, Jr., an enrolled agent, who stated that the auditor determined that petitioner "had adequate books and records".

SUMMARY OF THE PARTIES' POSITIONS

The Division emphasizes that the auditor "[m]ade in effect four written requests [for petitioner's books and records] and reasonably believed that his notifications were being

¹²Petitioner introduced photographs of two competitors not three as claimed. Photographs marked petitioner's Exhibits "18" and "19" were of the same competitor.

ignored" (tr., p. 246). The Division points to the Tribunal's decision in the earlier matter involving petitioner, Matter of Trusnovec (March 6, 1993), in support of its contention that it was reasonable to rely on audit results from this earlier period after the auditor verified that petitioner's business had not declined by his head count of customers entering the delicatessen. In any event, the Division maintains that the records which were finally provided at the conference in the Bureau of Conciliation and Mediation Services were inadequate due to the lack of any source documents showing individual sales,

and the Division would have been entitled to estimate petitioner's taxable sales even if the auditor had obtained access to petitioner's books and records in the first instance:

"The bottom line is that even though the notices were reasonably assessed, based on the initial audit, Mr. Trusnovec was not prejudiced by their issuance because he protested timely and still had whatever records he had examined" (tr., p. 250).

According to the Division, petitioner's recordkeeping was found to be inadequate by the Tax Appeals Tribunal in the prior audit, and since petitioner's recordkeeping remained the same, it was properly viewed as inadequate for this audit. In addition, the Division notes that it is not enough for petitioner to criticize the audit, but rather he was required to show by clear and convincing evidence "what the true tax liability is" (tr., p. 253). The Division also argued that penalties were properly imposed given the failure of petitioner to alter his inadequate method of accounting for taxable sales after two prior audits.

Petitioner countered by emphasizing his long and troubled relationship with the State tax authorities in the course of income tax and multiple sales tax audits:

"Talking total hell is what we have gone through. Because of how we got behind is all because of my father becoming terminally ill and me being run over. That started it and never, never corrected it" (tr., pp. 265-266).

Volunteering to take a lie detector test, Mr. Trusnovec contended that his records were accurate:

"We don't have the money to have these fancy registers and computers and things like that. Those are accurate books and records. All the receipts are in there. All the checks were in there. All the cash register tapes for each day were in there" (tr., p. 267).

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices. However, the Division may not utilize external indices unless it first determines that the taxpayer's books and records are inadequate for purposes of verifying sales and purchases subject to sales and use taxes (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43). If the taxpayer's records are inadequate, the Division must then select a method of audit reasonably calculated to reflect taxes due (Matter of Grecian Square v. State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221), and the burden is on the taxpayer to establish by clear and convincing evidence that the method used to arrive at the tax assessment and the assessment are erroneous (Matter of Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943, 512 NYS2d 542, 543). Furthermore, the Tax Appeals Tribunal has noted that:

"[w]here the taxpayer establishes that the audit methodology is based on an assumption that is fundamentally flawed, the taxpayer has sustained his burden of proof and is not required to show the exact amount of taxes due [citations omitted]" (Matter of Bernstein-On-Essex, Tax Appeals Tribunal, December 3, 1992).

B. To determine the adequacy of a taxpayer's records, the Division must first request and thereafter thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109; Matter of King Crab Restaurant v. State Tax Commn., 134 AD2d 51, 522 NYS2d 978). The purpose of this examination is to determine whether the taxpayer's books and records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn., supra; Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal, May 11, 1989). Where the Division follows such steps, it then may resort to external indices to estimate tax.

C. It cannot be concluded that the Division took all of the necessary steps, in the very

special circumstances of the matter at hand, before resorting to an estimate of tax for purposes of the issuance of the statutory notices at issue. As noted in Findings of Fact "3" and "5" petitioner had been the subject of two prior sales tax audits as well as a personal income tax audit by the time the third sales tax audit at issue here commenced. In fact, the audit at issue was commenced even before the Administrative Law Judge had issued his determination concerning the second sales tax audit. Given this prior relationship between the Division and petitioner, it cannot be concluded that merely mailing the appointment letter to petitioner was adequate given the lack of a response to the mailings.

It is noted that petitioner has denied that he received any of the mailings of the appointment letter. The incomplete address, which lacked a post office box, together with petitioner's testimony and the letter from the Key Bank official support a conclusion that petitioner did not in fact receive any of the mailings. Further, a review of the certified mailing of the letter, as noted in Finding of Fact "4", shows that such mailing was "unclaimed" not "refused".

As noted in Finding of Fact "5", the auditor admitted that his usual practice would have been to phone or make personal contact, given the return of the certified mailing and the lack of response to his other mailings, if petitioner had not antagonized other auditors in the past. First, it must be emphasized that even if Mr. Trusnovec had frustrated auditors in the past, the auditor should have attempted to either make personal service of the appointment letter or at least a phone call to petitioner's business phone. At no time does the record show that petitioner threatened or used any sort of physical force against State auditors, which might perhaps justify an auditor to ignore his usual practice of a phone call or personal contact in order to inform a taxpayer of his need to review books and records in order to commence an audit when mailings are not being received or responded to by a taxpayer and when he knows the whereabouts of the taxpayer. Furthermore, it cannot be said that it was unreasonable for petitioner to refuse to permit an observation test on his business premises when he was not present, and was apparently attending a meeting with personal income tax auditors. The business at issue is a

family-operated delicatessen, and petitioner had an understandable interest to be present for the second observation test. In sum, the fact that the auditors involved in the prior audit might have been frustrated by their inability to conduct an observation test, when they chose, did not justify the failure of the auditor in this matter to phone or make physical contact with petitioner concerning the commencement of the third audit. Moreover, as noted in Finding of Fact "5", the auditor was even inside petitioner's delicatessen and could have easily delivered another copy of his appointment letter. It is noted that the facts and circumstances in this matter are unlike those in Matter of Clone Enterprises (Tax Appeals Tribunal, March 19, 1992) where there was a studied disregard of requests for records by the taxpayers.

D. The Division has argued that petitioner was not "prejudiced" by the lack of any review of his books and records. According to the Division, petitioner's books and records were reviewed at the direction of the conferee, as noted in Finding of Fact "10", and such review established that his books and records remained inadequate. The delicatessen's recordkeeping for the period at issue was the same as it had been for the period which was the subject of the second audit, and such recordkeeping had been determined to be inadequate by the earlier determination which was affirmed by the Tax Appeals Tribunal.

However, it is observed that the Division was required to review petitioner's books and records for purposes of determining their adequacy prior to the issuance of the statutory notices, which were based on an estimation of sales. As a result, the statutory notices, which were based upon an estimate of taxable sales may not be sustained (see, Matter of Arper Discount Center, Tax Appeals Tribunal, June 27, 1991). It is noted that the situation at hand is unlike the circumstances in Matter of Morano's Jewelers (Tax Appeals Tribunal, January 21, 1991 [wherein the Tribunal noted that the taxpayer could not refuse to allow the Division further access to its books and records and that there was no obligation upon the Division "to follow alternative means to access such records"])). In the matter at hand, petitioner never, in fact, refused to allow the Division access to his books and records.

E. The Tax Appeals Tribunal, in Matter of Bleistein (August 11, 1994), noted that

Administrative Law Judges may not "moot" issues and directed the analysis of all issues raised by the parties in the administrative hearing. Consequently, the issues designated "II" through "V" will be addressed.

F. Every person required to collect sales tax must maintain records sufficient to verify all transactions, in a manner suitable to determine the correct amount of tax due (Tax Law § 1135[a]; 20 NYCRR 533.2[a]). As noted in Finding of Fact "17", petitioner did not maintain cash registers which registered and produced tapes showing the specific nature of individual transactions. As a result, individual sales transactions were not subject to independent review and verification. Consequently, the Division could properly resort to methodologies for estimating petitioner's taxable sales (see, Oak Beach Inn Corp. v. Wexler, 158 AD2d 785, 551 NYS2d 375; Matter of Del's Mini Deli, Tax Appeals Tribunal, April 18, 1993). Petitioner's complaint, as noted in paragraph "21", that he could not afford registers that could provide such detail rings hollow given the volume of his delicatessen's sales and the fact that he has not upgraded his cash registers for approximately 20 years.

G. The one-day observation test described in detail in Finding of Fact "12" was carefully performed by the Division and provided a reasonable basis for estimating petitioner's taxable sales (see, Matter of Agnone, Tax Appeals Tribunal, January 23, 1992 [wherein the Tribunal upheld the results of a one day observation test and noted that precision in determining taxable sales was not required when lack of adequate records required the estimation of taxable sales]; Matter of Sarantopoulos, Tax Appeals Tribunal, February 28, 1991 [one day observation test upheld]). As noted in Finding of Fact "19", petitioner's testimony that results from his own observation tests varied significantly from the Division's can be given little weight. Petitioner's testimony, which was unsupported by detailed documentation like the Division's documentation of its observation test, fell far short of the "clear and convincing evidence" petitioner was required to produce to undercut the Division's estimate of his taxable sales (see, Center Moriches Monument Co. v. Commr. of Taxation & Fin., ___ AD2d ___, 621 NYS2d 720). Furthermore, petitioner's testimony that the farmstand created more business for his delicatessen

on the day of the observation test did not rise to the level of "clear and convincing evidence" especially without documentation for this claim. The Division carefully noted the number of customers in petitioner's delicatessen on the day of the observation test. Petitioner offered no documentation of a lower customer count during the period at issue.

H. Finally, the fact that the observation test as performed established substantial and continued underreporting of taxable sales justified the imposition of penalties against petitioner (see, Matter of Mustafa, Tax Appeals Tribunal, December 27, 1991).

I. The petition of Robert Trusnovec is granted and the notices of determination dated June 18, 1990 are cancelled.

DATED: Troy, New York
May 18, 1995

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE